

FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, D.C. 20426

In Reply Refer To:  
Office of Enforcement  
Docket No. PA15-7-000  
August 16, 2016

Empire District Electric Company  
Attention: Kelly Walters  
Vice President and Chief Operating Officer  
P.O. Box 127  
Joplin, MO 64802

Dear Ms. Walters:

1. The Division of Audits and Accounting (DAA) in the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (Commission) has completed an audit of Empire District Electric Company (Empire). The audit covered the period from January 1, 2010 through December 31, 2015.
2. The audit evaluated Empire's compliance with the requirements of: (1) its market-based rate (MBR) authorizations, including, but not limited to, the Commission's MBR regulations under 18 C.F.R. § 35 Subpart H and Electric Quarterly Report filing regulations under 18 C.F.R. § 35.10b; and (2) the FERC Form No. 552, Annual Report of Natural Gas Transactions under 18 C.F.R. § 260.401. The audit also examined Empire's wholesale electric and natural gas market activity, including compliance with applicable tariff provisions and Commission regulations over natural gas transportation and sales under 18 C.F.R. Part 284.
3. On July 15, 2016, you notified DAA that Empire agreed with each of the audit report's seven recommendations and accepted both of the audit findings. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.
4. Empire should submit its implementation plan to comply with the recommendations within 30 days of this letter order. Empire should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar

Empire District Electric Company

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quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311 (2015). This letter order constitutes final agency action. Empire may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713 (2015).

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of non-compliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Bryan K. Craig, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-8741.

Sincerely,

Larry R. Parkinson  
Director  
Office of Enforcement

Enclosure



**Federal Energy Regulatory Commission**  
**Office of Enforcement**  
**Division of Audits and Accounting**

**Audit of Market-Based Rate  
Authority, Electric Quarterly  
Report Requirements, and FERC  
Form No. 552 for Empire District  
Electric Company**

Docket No. PA15-7-000  
August 16, 2016

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## I. Executive Summary

### A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement (OE) has completed an audit of Empire District Electric Company (Empire or the Company). The audit evaluated Empire's compliance with the requirements of: (1) its market-based rate (MBR) authorizations, including, but not limited to, Commission MBR regulations under 18 C.F.R. § 35 Subpart H and Electric Quarterly Report (EQR) filing regulations under 18 C.F.R. § 35.10b and (2) the FERC Form No. 552, Annual Report of Natural Gas Transactions under 18 C.F.R. § 260.401. The audit also examined Empire's wholesale electric and natural gas market activity, including compliance with applicable tariff provisions and Commission regulations over natural gas transportation and sales under 18 C.F.R. § 284. The audit covered January 1, 2010 to December 31, 2015.

### B. Empire District Electric Company

Empire is an investor-owned utility headquartered in Joplin, MO, that owns both generation and transmission assets in Missouri, Kansas, Arkansas, and Oklahoma. Empire is a member of the Southwest Power Pool, Inc. (SPP) and has been authorized by the Commission to sell power, capacity, and ancillary services at market-based rates. As a member of SPP, Empire's transmission assets are under the functional control of SPP and subject to the SPP Open Access Transmission Tariff (OATT). Under the SPP OATT, Empire has a transmission formula rate, which was authorized by the Commission in 2013, and a generation formula rate, which was authorized in 2011. Empire does not have a parent company, service company, or any affiliates that own or control generation or transmission assets.

### C. Summary of Compliance Findings

Below is a summary of audit staff's compliance findings. Audit staff identified two areas of noncompliance. Section IV details these noncompliance findings identified as a result of this audit.

- *Reporting of Energy and Capacity Sales in the EQR* – Empire did not report its wholesale sales to four municipalities within Empire's service territory or wholesale sales made from its hydro facility. As a result, Empire under-reported its sales in its EQRs by \$121,910,668 and 2,089,983 MWh during the audit period. These omissions hampered the Commission and interested parties' ability to review and evaluate Empire's wholesale sales activity.

- *Accuracy of Data Reported in the EQR* – Empire’s EQRs during the audit period contained various errors in the contracts and transactions it reported, including incorrect prices, quantities, customers, points of delivery, and affiliate identifications. These errors resulted from the Company’s inadequate oversight of its EQR processes and procedures, hampering the Commission and interested parties’ ability to review and evaluate Empire’s wholesale sales activity.

#### **D. Summary of Recommendations and Corrective Actions Taken**

Below is a summary of audit staff’s recommendations to remedy the findings and other matters in this report. Detailed recommendations are in section IV. Audit staff recommends that Empire:

##### *Reporting of Energy and Capacity Sales in the EQR*

1. Conduct an internal review of its deal capture system and financial records to ensure that it is properly coding, tracking, and reporting in its EQRs all wholesale sales of energy, capacity, and ancillary services.
2. Refile all affected EQRs to include the missing transactions identified in this finding and any additional findings identified through internal review.
3. Modify written policies and procedures to include a reconciliation of deal capture data used for EQR reporting with existing counterparty contracts and settlement data used for financial reporting purposes to ensure that all future EQR filings are complete and accurate.
4. Conduct training of all staff that prepare, review, and file the EQRs to ensure proper interpretation and compliance with Commission EQR reporting requirements.

##### *Accuracy of Data Reported in the EQR*

5. Conduct an internal review of its EQR filings from Q3 2013 to present to identify any additional inaccurate or inconsistent data.
6. Refile all affected EQRs filed from Q3 2013 to present, addressing the findings identified in this audit report and any additional findings identified through internal review.
7. Modify written policies and procedures and institute appropriate controls within 90 days of issuance of this audit report to ensure that all future EQR filings are complete and accurate.

**E. Compliance and Implementation of Recommendations**

Audit staff further recommends that Empire submit for audit staff review:

- A plan for implementing audit staff's recommendations. Empire should provide this plan to DAA within 30 days after the final audit report is issued.
- Quarterly reports to DAA describing Empire's progress in completing each corrective action recommended in the final audit report. Empire should make these nonpublic quarterly filings no later than 30 days after the end of each calendar quarter, beginning with the first quarter after submission of the implementation plan, and continuing until Empire completes all recommended corrective actions.
- Copies of any written policies and procedures developed in response to the recommendations in the final audit report. These documents should be submitted for audit staff's review in the first quarterly filing after Empire completes the products.

## II. Background

### A. Corporate Overview

Empire operates its business in three main segments: an electric segment, a gas segment, and a fiber optics segment. Through its electric segment, the Company is engaged in the generation, purchase, transmission, distribution, and sale of electricity to approximately 170,000 customers located principally in southwestern Missouri as well as smaller areas in southeastern Kansas, northeastern Oklahoma, and northwestern Arkansas. Empire owns 1,280 MW of natural gas, coal, and hydro generating assets that it offers into the SPP markets, imports an additional 50 MW of generation located in the Midcontinent Independent System Operator, Inc. (MISO) market to serve Empire's load, and has long-term power purchases of 305 MW of generation capacity that it offers into the SPP market. Empire owns 1,254 miles and 6,932 miles of transmission and distribution lines, respectively.

The gas segment of Empire's business is conducted principally through its wholly owned subsidiary, Empire District Gas Company (EDG). EDG is a local distribution company (LDC) engaged in the distribution of natural gas to approximately 43,200 customers in northwest, north central, and west central Missouri. EDG owns and operates approximately 87 miles of transmission mains and approximately 1,189 miles of distribution mains.

### B. MBR Authority

Empire has authority from the Commission to sell energy, capacity, and ancillary services at market-based rates.<sup>1</sup> Empire owns more than 500 MW of generation within the SPP region and is therefore a Category 2 seller within SPP, but is a Category 1 seller in all other geographic regions.<sup>2</sup> Empire filed an updated market power analysis in

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<sup>1</sup> *The Empire District Electric Co.*, Docket No. ER14-793-001, (Mar. 13, 2014) (delegated letter order).

<sup>2</sup> 18 C.F.R. § 35.36 defines a Category 1 seller as a seller that (1) is either a wholesale power marketer that controls or is affiliated with 500 MW or less of generation in aggregate per region or a wholesale power producer that owns, controls or is affiliated with 500 MW or less of generation in aggregate in the same region as its generation assets; (2) does not own, operate or control transmission facilities other than limited equipment necessary to connect individual generating facilities to the transmission grid (or has been granted waiver of the requirements of Order No. 888, FERC Stats. & Regs. ¶31,036); (3) is not affiliated with anyone that owns, operates or controls transmission facilities in the same region as the Seller's generation assets; (4) is not affiliated with a franchised public utility in the same region as the Seller's generation assets; and (5) does



compliance with Order No. 697 on June 30, 2015, which was accepted by the Commission on November 17, 2015.<sup>3</sup>

Empire first requested and received Commission authority to sell electricity and capacity at market-based rates in 1999.<sup>4</sup> In 2004, Empire transferred functional control of its transmission facilities to SPP.<sup>5</sup> In 2006, Empire gained authority to sell imbalance energy into the SPP energy imbalance market, and in 2014, gained further authority for the sale of ancillary services at market-based rates in the SPP, PJM Interconnection, LLC (PJM), and Midcontinent Independent System Operator, Inc. (MISO) markets.<sup>6</sup> Empire operated under a mitigated service territory provision of its MBR authority from November 2006 to March 2014. In 2014, Empire's transmission assets were fully integrated into SPP and Empire's MBR authority was revised to remove the mitigated service territory provision.<sup>7</sup>

### C. Mitigated Service Territory Provision

In 2004, the Commission issued orders implementing procedures for conducting generation market power screens for public utilities with MBR authority approved by the Commission.<sup>8</sup> On September 27, 2004, and September 28, 2004, as amended on December 15, 2005, Empire submitted its updated market power analysis. In an order

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not raise other vertical market power issues. A Category 2 seller is a seller not in Category 1.

<sup>3</sup> *The Empire District Electric Company*, Docket No. ER10-2738-003 (Nov. 17, 2015) (delegated letter order).

<sup>4</sup> *Rockingham Power, L.L.C.*, Docket No. ER99-1597-000 (Mar. 31, 1999) (delegated letter order).

<sup>5</sup> *See The Empire District Electric Co.*, Docket No. ER03-167-000 (delegated letter order) (Jan. 10, 2003). *See also, Southwest Power Pool, Inc.*, 82 FERC ¶ 61,267 (1998), 82 FERC ¶ 61,285 (1998), *order on reh'g*, 85 FERC ¶ 61,031 (1998) (transmission service on Empire's transmission system has been under the SPP OATT since June 1, 1998).

<sup>6</sup> *The Empire District Electric Co.*, Docket No. ER14-793-001, (delegated letter order) (Mar. 13, 2014) (accepting Empire's notice of change-in-status filing and proposed tariff changes to remove tariff provisions limiting Empire's market-based rate authority in the SPP market in anticipation of the start of the SPP Integrated Market).

<sup>7</sup> *Id.*

<sup>8</sup> *See Acadia Power Partners, LLC*, 107 FERC ¶ 61,168 (2004), *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018, at PP 151-155, *order on reh'g*, 108 FERC ¶ 61,026 (2004).

issued March 3, 2005, acting on Empire's updated market power analysis, the Commission found that Empire failed the wholesale market share screen for each of the four seasons considered in Empire's control area.<sup>9</sup> Accordingly, the Commission instituted a proceeding under section 206 of the Federal Power Act (FPA) to investigate generation market power in the Empire control area and to determine whether Empire would be able to continue to charge market-based rates within the Empire control area. The Commission also established a refund effective date pursuant to the provisions of section 206.

In the March 3, 2005 order, the Commission directed Empire to either: (1) file a Delivered Price Test analysis; (2) file a mitigation proposal tailored to its particular circumstances that would eliminate the ability to exercise market power; or (3) inform the Commission that it will adopt default cost-based rates or propose other cost-based rates and submit cost support for such rates.

On May 2, 2005, as supplemented by subsequent filings and revised further after Commission response on September 14, 2006, Empire submitted a mitigation proposal to eliminate its ability to exercise market power within its control area. In November 2006, the Commission accepted Empire's mitigation proposal in the Empire balancing authority.<sup>10</sup>

In December 2013, Empire filed to remove from its market-based rate tariff provisions limiting Empire's market-based rate authority in the SPP market.<sup>11</sup> In its filing (and supplements), Empire demonstrated that it no longer possessed market power because: (1) Empire's transmission assets were fully integrated into SPP in 2014, and (2) Empire would participate in SPP's Integrated Marketplace (SPP IM), and its market activities in the IM would be monitored by SPP's market monitoring unit. The Commission accepted removal of Empire's mitigated service territory provision of its MBR authority effective March 1, 2014.<sup>12</sup>

#### **D. Wholesale Electric Marketing and Trading**

Since March of 2014, Empire has participated in SPP's Integrated Marketplace (SPP IM) which acts as the central balancing authority operating a reliability unit commitment process, a real-time balancing market and an operating reserve market, and a

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<sup>9</sup> *The Empire District Electric Company*, 110 FERC ¶ 61,214 (2005).

<sup>10</sup> *The Empire District Electric Company*, 116 FERC ¶ 61,150 (2006).

<sup>11</sup> *See Public Service Company of Colorado*, 146 FERC ¶ 61,137 (2014).

<sup>12</sup> *The Empire District Electric Co.*, Docket No. ER14-793-001, (Mar. 13, 2014) (delegated letter order).

day-ahead market with transmission congestion rights. Empire offers its generation units and bids its load into the SPP market and the market determines the most economical and reliable commitment and dispatch of all resources offered into the market. Prior to launch of the SPP IM, Empire participated in the SPP Energy Imbalance Services Market (SPP EIS). Empire would offer its resources into the marketplace providing energy imbalance and would engage in bilateral transactions on a daily basis to market excess power and purchase power to serve its load.

Since the launch of the SPP IM, Empire has primarily relied upon the market selecting its generating units for commitment and dispatch to meet its load, and rarely engages in bilateral transactions. Citing a lack of liquidity and increased risk, Empire has not engaged in any day-ahead bilateral transactions since the launch of the SPP IM, and has sparingly made real-time bilateral power sales when its online generating units had excess capacity or its offline units were available to be started very quickly. The bilateral purchased power transactions Empire pursued did not yield pricing acceptable to Empire so those transactions were not completed.

Empire's marketing and trading is organized into front-office (operations) and back-office (settlements/reporting) functions. Empire's front-office traders focus on both real-time and day-ahead horizons, managing Empire's power needs through the balance of the day-ahead period (could be multiple days in the future), next day, and current day operations. The traders use optimization software to determine resource needs and enter into bilateral transactions, as needed, to avoid committing its highest priced resources. After Empire traders and the counterparties agree on terms, all transactions are subject to trading limits and must be approved by Empire's management. Bilateral transactions are entered into an SPP trade recording system so that SPP can settle the market side of the transaction. The Empire trader also enters the deal into Empire's deal capture system (which Empire uses to internally track all transactions) and notifies the back-office staff when there is a counterparty transaction. Empire's Supply Management Group summarizes physical energy purchases on a daily basis, and produces periodic power and fuel variance reports for distribution to various parts of the company, including its executive officers.

## **E. Wholesale Natural Gas Marketing and Trading**

Empire engages in natural gas marketing and trading activities with two main purposes: (1) to satisfy the fuel needs of its electricity generation fleet and (2) to satisfy the needs of its end-use natural gas customers in its service territory. Empire meets the majority of its natural gas fuel needs for its generation fleet through short-term forward contracts and spot market purchases. It hedges natural gas commodity prices and volumes several years into the future per its risk management plan. Empire buys gas for its gas-fired generators based on each day's expected operations.

Empire District Gas Company (EDG) is a subsidiary of Empire. It is a local gas distribution company (LDC) that purchases natural gas for direct delivery to customers. Its distribution system is connected to the ANR Pipeline Company, the Panhandle Eastern System, and the Southern Star Central Gas Pipeline Company. EDG's staff reviews customers' expected natural gas requirements for each particular month and incorporates additional factors, such as weather and contract limitations, to determine how much gas to purchase.

EDG's contracts with ANR Pipeline and Panhandle Eastern Pipeline allow it to supply the winter load requirements (November through March) for its distribution system sections directly connected to those pipelines without purchasing additional gas supplies other than daily peaking needs due to colder-than-normal temperatures. EDG's contract with Southern Star has limitations only allowing for approximately 23 percent of EDG's expected supply to its customers connected to that pipeline so during winter months EDG staff performs analysis of any known pertinent market information to determine how much natural gas to purchase at the beginning of each month on Southern Star. Unlike purchases for Empire's generation fleet, EDG purchases of natural gas are generally at an index price. It typically only buys gas on a daily basis for peaking purposes or injection into storage at opportunistic prices.

#### **F. Risk Management and Compliance Oversight**

Empire maintains formal risk management policies and staff that manage business, financial, and regulatory risks associated with Empire's electric and natural gas trading activities. Empire's risk management over its trading is primarily focused on managing market risk and credit risk, which are overseen by Empire's Risk Oversight Committee and compliance function.

Empire engages in hedging to reduce its exposure to large fluctuations in fuel and power prices, utilizing hedges and contracts to manage its fuel risk related to gas and coal. In 2013, Empire began purchasing Transmission Congestion Rights (TCRs) to manage power costs associated with congestion. Coal is the primary fuel used in Empire's generation fleet, and Empire has entered into a combination of short- and long-term contracts to meet its hedging objectives (e.g. one year out: target of a minimum of 60 percent hedged; two years out: target up to 40 percent hedged; etc.).

Empire manages its generation fleet's gas fuel risk through physical forward and derivative contracts as well as the use of gas storage. Empire also manages the fuel risk associated with EDG's gas delivery needs through the use of derivatives, future forward contracts, and injection of gas into storage during off-peak seasons. Like its generation fleet, Empire has set fuel hedge targets for EDG. Empire is able to mitigate some fuel risk by its ability to recover fuel costs in the rates for both its generation fleet and EDG.

Empire staff monitors daily and monthly prices throughout the day. Trade details are recorded and sent to a back-office group for verification of accuracy. Empire's Risk Management Policy dictates the bounds in which a natural gas trade can be transacted and recorded. Empire estimates its long-term gas needs and its risk management policy determines the limits for hedging any long-term purchases. The long-term purchases can be financial or physical gas that is generally purchased at a fixed price.

The majority of Empire's credit risk exposure is associated with entities that provide its fuel. Empire evaluates counterparty financial condition and other factors when assessing hedging and trading activities, and some counterparties provide collateral or prepay according to Empire's credit policy. Nearly all non-EDG financial trades are made on the NYMEX utilizing a commodity trading platform, with the NYMEX providing an end-day activities report for review. EDG trade details are emailed to electric company management for recordation in the commodity trading platform, and Empire's trade management staff oversees the trade activity and the accuracy of associated records. Beginning in 2014, Empire further enhanced its oversight activities by creating monthly variance reports to compare MISO- and SPP-supplied expenses and revenue to budget. Empire's mid-office staff uses these reports to detail variances with the resulting information compared to other internally generated reports to verify accuracy before this information is distributed to senior management.

### III. Introduction

#### A. Objectives

Audit objectives included evaluation of Empire's compliance with the requirements of: (1) its market-based rate authorizations and EQR filing regulations; and (2) the FERC Form No. 552, Annual Report of Natural Gas Transactions. The audit also examined Empire's wholesale electric and natural gas market activity, including compliance with applicable tariff provisions and Commission regulations over natural gas transportation and sales under 18 C.F.R. § 284. The audit covered January 1, 2010 to December 31, 2015.

#### B. Scope and Methodology

Audit staff reviewed publicly available and company-provided information to evaluate compliance risk. Audit staff then conducted substantive testing to determine whether Empire complied with its MBR authorizations, EQR requirements, and Form No. 552 instructions.

Audit staff performed these actions to facilitate testing and evaluation of Empire's compliance with Commission requirements relevant to audit objectives:

- *Reviewed Public Information* – Conducted an extensive review of public information during the planning phase of the audit. This review provided a high-level understanding of Empire's corporate structure, wholesale natural gas and electric trading, reporting, and other key regulatory and business activities. Examples of materials reviewed include Empire's MBR authorization applications and associated Commission orders, triennial market power analyses, EQR filings, Form No. 552 filings, company-related web sites, and other relevant regulatory and media sources.
- *Identified Audit Criteria* – Identified audit criteria, including Commission rules, regulations, and other requirements necessary to evaluate compliance with the audit objectives.
- *Issued Data Requests* – Issued data requests to collect information not commonly available to the public. This information related to policies, procedures, and controls; business practices; risk management; wholesale natural gas and electric trading strategies and activity; financial accounting and reporting activity; corporate compliance; regulatory filings; and other pertinent information. This data was used to test and evaluate compliance with Commission requirements relevant to the audit objectives.

- *Conducted Teleconference Interviews* – Conducted multiple teleconferences with employees to discuss audit objectives, testing, data request responses, technical and administrative matters, and compliance concerns.
- *Conducted a Site Visit* – Conducted one site visit to Empire headquarters in Joplin, MO, to discuss and observe controls and procedures related to audit objectives. For example, to understand the structure of Empire’s compliance program, audit staff interviewed traders and front-, mid-, and back-office staff, senior officials, managers, and employees who fulfill daily compliance activities and perform regulatory oversight.

Audit staff performed additional testing to evaluate Empire’s compliance with requirements relevant to the audit scope, as outlined below.

### Wholesale Energy Trading

In reviewing Empire’s wholesale electric trading activities to determine compliance with its policies, procedures, and controls, audit staff:

- *Gained familiarity with business operations* – Reviewed information on the company’s wholesale electric trading business operations gathered in data requests, conference calls, and interviews. Gained an understanding of the structure, activities, and goals of this business segment. This information was used to identify relevant procedures and controls and plan further testing.
- *Reviewed risk management framework and operational controls* – Reviewed procedures and controls covering wholesale electric trading, including risk management policies, compliance principles, trading activity limits, and others. Reviewed controls to mitigate risk, and reviewed surveillance tools, performance targets, limits on trading, and any behavioral or conduct rules placed on traders and other employees.
- *Reviewed daily operations* – Gathered data from and conducted interviews with front-, mid-, and back-office staff to understand the responsibilities of each group and how they interact. Reviewed alignment of daily operations to procedures and controls.
- *Reviewed management oversight* – Identified and interviewed supervisors with management responsibilities over staff with trading, accounting, and reporting responsibilities. Reviewed methods managers used to monitor employees’ activities, including tools used, practices employed to identify and investigate

concerns, and steps to assess the sufficiency and effectiveness of implemented policies and controls.

- *Reviewed the deal capture system* – Reviewed and discussed in detail the functionality of the deal capture system, including processes to execute, manage, and account for trades. Observed operation of automated and manual controls intended to mitigate the risk of trades failing to be correctly classified and recorded in Empire’s system.
- *Sampled transactions* – Reviewed the effectiveness of controls, processes, and procedures by sampling transactions and tracking the flow of a trade from initiation through the deal capture system to recording in the general ledger.
- *Sampled and tested transaction accounting* – Assessed the processes and procedures used to account for trading activity, including accounting for derivative and hedging instruments. Reviewed a sample of transactions to evaluate whether designated hedges were appropriate, and the assessment of hedge effectiveness was based on documented policy. Also, reviewed and tested a sample of emission allowance transactions and expenses associated with political and civic activities.
- *Assessed recruiting and compensation policies* – Assessed how Empire recruits and pays employees. Reviewed the methods for screening prospective employees, and reviewed how compensation correlated to compliance with policies and procedures.

### MBR and EQR Activities

In reviewing Empire’s MBR and EQR activities to determine compliance with the applicable Commission regulations, audit staff:

- *Reviewed Commission filings* – Reviewed MBR applications, market power analysis filings, change-in-status filings, and associated Commission orders. Reviewed representations made in market power analysis and change-in-status filings to determine whether they consistently and accurately reported information about assets owned and controlled.
- *Compared data reported to other government agencies* – Verified that information reported to the Commission on operating characteristics of generating assets is similar to information reported to the Energy Information Administration to assess the accuracy of generator nameplate and summer ratings.



- *Reviewed MBR controls* – Reviewed policies and procedures, and interviewed employees, to determine how information on acquisition and disposition of assets that may affect MBR authority is communicated among the organization to ensure timely and accurate change-in-status and market power analysis filings.
- *Reviewed EQR controls* – Reviewed processes, procedures, and controls with respect to EQR filings, and interviewed employees to evaluate processes used to collect, compile, and file EQR data.
- *Reviewed the deal capture system* – Reviewed the IT systems used for trading and EQR reporting, which included an observation of the operation of tools, processes, and procedures used to initiate trade transactions and a review of the other process culminating with EQR reporting.
- *Tested power sales* – Analyzed EQR transactions to assess whether Empire complied with restrictions against market-based energy sales within its balancing authority area in the SPP region.
- *Consulted with other Commission offices* – Discussed MBR and EQR compliance issues with Commission staff in other program offices and divisions in OE to identify risk concerns seen throughout the industry. For instance, audit staff consulted with EQR technical staff from OE about EQR reporting requirements.

#### Form No. 552 Reporting

In reviewing Empire's Form No. 552 reporting to determine compliance with the applicable reporting requirements, audit staff:

- Analyzed Form No. 552 filings during the audit period.
- Interviewed employees to understand the filing processes and procedures of its Form No. 552 filings across subsidiaries. Determined whether the company reported on a stand-alone basis or in aggregation with its subsidiary local distribution company.
- Tested Form No. 552 filings against underlying data for any restricted or misclassification of transactions. Verified the total wholesale natural gas purchase and sale volumes reported on Form No. 552.

- Interviewed employees to identify all affiliates that bought and sold physical natural gas subject to reporting requirements of Form No. 552 during the audit period.

### Compliance Program

Also, audit staff reviewed whether Empire's regulatory compliance program for audit scope areas was consistent with criteria in the Commission's *Policy Statement on Compliance*.<sup>13</sup> Audit staff:

- Reviewed Empire's regulatory compliance program structure, including its authority and responsibilities for overseeing corporate compliance and the delegation of compliance responsibilities at the department level.
- Interviewed executives, managers, and operational employees to evaluate their knowledge and application of compliance program policies and procedures. These interviews also helped audit staff understand company compliance training.
- Reviewed the Internal Audit department's activities and a sample of work products. Also, reviewed the composition and organization of the Internal Audit department, including its lines of authority and reporting, and its processes and procedures to assess whether recommendations to audited business units and processes were implemented.
- Reviewed the procedures and system used to track employee training. Also, observed a demonstration of the training system, interviewed employees who used and maintained the system, and analyzed a sample of training documentation for employees who work in trading operations.

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<sup>13</sup> *Policy Statement on Compliance*, 125 FERC 61,058 (2008).

## IV. Findings and Recommendations

### 1. Reporting of Energy and Capacity Sales in the EQR

Empire did not report its wholesale sales to four municipalities within Empire's service territory or wholesale sales made from its hydro facility. As a result, Empire under-reported its sales in its EQRs by \$121,910,668 and 2,089,983 MWh during the audit period. These omissions hampered the Commission and interested parties' ability to review and evaluate Empire's wholesale sales activity.

#### Pertinent Guidance

Order No. 2001 requires companies to report EQR data that fall into two main categories: contract data and transaction data.<sup>14</sup> Contract data must include contractual terms and conditions in the agreements for all jurisdictional services, including market-based power sales, cost-based power sales, and transmission service.<sup>15</sup> Transaction data must include sales of capacity, energy, and ancillary services made under such contracts.<sup>16</sup> Order No. 2001 also requires that power transactions that make up bookout transactions be reported in EQRs.<sup>17</sup> Order No. 2001-A clarifies the reporting requirement for bookout transactions.<sup>18</sup>

18 C.F.R. § 35.10b requires each public utility to file an updated EQR with the Commission covering all services it provides pursuant to this part, for each of the four calendar quarters of each year. EQRs must be prepared in conformance with the Commission's software and guidance posted and available for downloading from the FERC web site ([www.ferc.gov](http://www.ferc.gov)).

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<sup>14</sup> *Revised Public Utility Filing Requirements*, Order No. 2001, FERC Stats. & Regs. ¶ 31,127 at P 21 (2002), *reh'g denied*, Order No. 2001-A, 100 FERC ¶ 61,074 (2002), *reh'g denied*, Order No. 2001-B, 100 FERC ¶ 61,342 (2002), *order directing filings*, Order No. 2001-C, 101 FERC ¶ 61,314 (2002), *order directing filings*, Order No. 2001-D, 102 FERC ¶ 61,334 (2003), *order refining filing requirements*, Order No. 2001-E, 105 FERC ¶ 61,352 (2003), *clarification order*, Order No. 2001-F, 106 FERC ¶ 61,060 (2004), *order revising filing requirements*, Order No. 2001-G, 120 FERC ¶ 61,270, *order on reh'g and clarification*, Order No. 2001-H, 121 FERC ¶ 61,289 (2007), *order revising filing requirements*, Order No. 2001-I, FERC Stats. & Regs. ¶ 31,282 (2008).

<sup>15</sup> *Id.* P 3.

<sup>16</sup> *Id.* at Attachment C.

<sup>17</sup> *Id.* P 285.

<sup>18</sup> Order No. 2001-A, 100 FERC ¶ 61,074 at P 22.

## Background

Audit staff noted large discrepancies between amounts of wholesale sales of energy and capacity reported by Empire in its EQR reports and its FERC Form No. 1 filings during the audit period. During fieldwork, audit staff identified certain wholesale sales of energy and capacity made by Empire to four municipalities and one public utility, Kansas City Power & Light (KCPL), which Empire did not report in its EQR filings. This resulted in Empire under-reporting sales of energy and capacity in its EQRs by \$121,910,668 and 2,089,983 MWh during the audit period.

### *Sales to Municipalities*

Empire provides full requirements wholesale electric service to four cities within its balancing authority area: the cities of Monett, Mt. Vernon, and Lockwood, MO; and the city of Chetopa, KS. Empire provides service to these city municipalities pursuant to a generation formula rate mechanism approved by the Commission, the terms of which were agreed upon in an uncontested settlement between the parties certified on July 13, 2011.<sup>19</sup> Prior to implementation of the generation formula rate, Empire provided bundled wholesale electric service to the municipalities pursuant to grandfathered agreements with stated rates under its cost-based wholesale electric service schedule.<sup>20</sup>

During fieldwork, audit staff discovered through its review of financial settlement data that Empire had not reported in its EQRs its sales of energy and capacity to the municipalities made pursuant to the generation formula rate or under the grandfathered rates. Empire stated that it was unaware of the reporting obligation for sales made to wholesale requirements customers and was under the false assumption that the EQRs should only contain sales made at market-based rates. However, audit staff informed Empire that the EQRs should contain all wholesale sales of energy, capacity, and ancillary services, including market-based power sales, cost-based power sales, and transmission service.<sup>21</sup>

During the audit period beginning January 1, 2010 through December 31, 2015, Empire made wholesale energy sales to the four city municipalities totaling \$64,573,413 and 2,083,895 MWh, and capacity sales totaling \$54,007,792 that Empire did not report in its EQRs. Audit staff's review of Empire's accounting records showed that Empire

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<sup>19</sup> *The Empire District Electric Co.*, 137 FERC ¶ 61,106 (2011).

<sup>20</sup> See *The Empire District Electric Co.*, 59 FERC ¶ 61,418 (1992), *The Empire District Electric Co.*, Docket No. ER03-626-000 (Apr. 25, 2003) (delegated letter order).

<sup>21</sup> See Order No. 2001, FERC Stats. & Regs. ¶ 31,127 at P 3.

properly booked the revenue from such sales in Account 447, Sales for Resale, and incorporated them into its customer rate determinations.

#### *Wheeling Transactions from Empire's Hydro Facility*

Empire had an agreement to provide wheeling transactions sourcing from Empire's hydro facility that are scheduled across the Empire system through a buy/sell arrangement that expired in March 2014. The operating and ownership agreement for the Ozark Beach Hydroelectric Plant provides for Empire to operate the plant while three city municipalities, the Kansas City Board of Public Utilities, Higginsville Electric, and Kaw Valley Electric, own title to the 16 MWs of peak energy output. Empire then purchases the output from the municipalities, takes title to the energy, and transmits the power across the Empire system and sells it to KCPL at the Empire control area interface with Southwestern Power Administration's system.

During fieldwork, audit staff discovered through its review of counterparty contracts and financial settlement data that these wheeling transactions from Empire's hydro facility were not reported in its EQRs. Even though Empire took title to the energy, scheduled transmission service across its system, and sold energy and capacity for resale to KCPL, Empire failed to report these sales in its EQRs. Empire stated that it was not an active participant in these transactions in that it did not determine when or how much energy it scheduled across its transmission system. However, audit staff notes that Empire recorded the revenues associated with these sales of energy and capacity to Account 447, Sales for Resale.

From January 1, 2011 through expiration of the buy/sell contract on February 28, 2014, Empire under-reported its energy sales in the EQR to KCPL by \$120,957 and 6,088 MWh, and capacity sales to KCPL totaling \$3,208,506. Audit staff's review of Empire's accounting records showed that Empire properly booked the revenue from such sales in Account 447 and incorporated them into its customer rate determinations.

#### **Recommendations**

We recommend that Empire:

1. Conduct an internal review of its deal capture system and financial records to ensure that it is properly coding, tracking, and reporting in its EQRs all wholesale sales of energy, capacity, and ancillary services.
2. Refile all affected EQRs to include the missing transactions identified in this finding and any additional findings identified through internal review.

3. Modify written policies and procedures to include a reconciliation of deal capture data used for EQR reporting with existing counterparty contracts and settlement data used for financial reporting purposes to ensure that all future EQR filings are complete and accurate.
4. Conduct training of all staff that prepare, review, and file the EQRs to ensure proper interpretation and compliance with Commission EQR reporting requirements.

## 2. Accuracy of Data Reported in the EQR

Empire's EQRs during the audit period contained various errors in the contracts and transactions it reported, including incorrect prices, quantities, customers, points of delivery, and affiliate identifications. These errors resulted from the Company's inadequate oversight of its EQR processes and procedures, hampering the Commission and interested parties' ability to review and evaluate Empire's wholesale sales activity.

### Pertinent Guidance

Order No. 2001 requires companies to report EQR data that fall into two main categories: contract data and transaction data.<sup>22</sup> Contract data must include contractual terms and conditions in the agreements for all jurisdictional services, including market-based power sales, cost-based power sales, and transmission service.<sup>23</sup> Transaction data must include sales of capacity, energy, and ancillary services made under such contracts.<sup>24</sup> Order No. 2001 also requires that power transactions that make up bookout transactions be reported in EQRs.<sup>25</sup> Order No. 2001-A clarifies the reporting requirement for bookout transactions.<sup>26</sup>

18 C.F.R. § 35.10b requires each public utility to file an updated EQR with the Commission covering all services it provides pursuant to this part, for each of the four calendar quarters of each year. EQRs must be prepared in conformance with Commission software and guidance posted and available for downloading from the FERC web site ([www.ferc.gov](http://www.ferc.gov)).

The EQR Data Dictionary states the following in part:

*Contract Affiliate* – indicate “Y” (yes) or “N” (no): if the customer is an affiliate if it controls, is controlled by, or is under common control with the seller. This includes a division that operates as a functional unit. A customer of a seller who is an Exempt Wholesale Generator may be defined as an affiliate under the Public Utility Holding Company Act and the FPA.

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<sup>22</sup> Order No. 2001, FERC Stats. & Regs. ¶ 31,127 at P 21 (2002).

<sup>23</sup> *Id.* P 3.

<sup>24</sup> *Id.* at Attachment C.

<sup>25</sup> *Id.* P 285.

<sup>26</sup> Order No. 2001-A, 100 FERC ¶ 61,074 at P 22.

*Point of Delivery –Specific Location* – the specific location at which the product is delivered. If receipt occurs at a trading hub, a standardized hub name must be used.

## Background

Audit staff reviewed supporting documentation associated with the sales reported by Empire in its EQR filings during the audit period and identified the following reporting errors:

1. *Incorrect transaction price and total transaction charge*

Empire incorrectly reported its sales to MISO during the audit period by: (1) reporting estimated prices, and (2) including a transmission adder in the price of energy sales made. In addition, Empire also incorrectly included a transmission adder for the sales it made to Tenaska Energy, Inc. (Tenaska) in Q1 2013. This resulted in inaccurate information being reported by Empire in its EQRs for its energy sales to MISO and Tenaska during the audit period.

During fieldwork, Empire explained that when it made a sale to MISO, its trader would enter a tentative price in its deal capture system obtained from a market report produced by MISO the day after the sale because the actual price wasn't available until the invoice was produced two weeks after the sale. Empire would then update the estimated prices with actual prices when available. However, if Empire made a sale for which the actual prices were not available prior to Empire's month-end closing process, which was the point at which Empire populated its EQRs, Empire would report the estimated prices in its EQRs rather than actual prices. Empire would make the adjustment to the estimated prices on its books in the following month, but since Empire had already pulled estimated prices into its EQRs, it did not report accurate prices for its sales to MISO in its EQRs.

Empire further explained that, in order to effectively evaluate its projected internal profit and loss associated with certain energy sales, Empire used its deal capture system to estimate transmission costs that were associated with the sales and included this amount as an adder to the total cost of energy. However, this transmission cost adder was incorrectly picked up during Empire's EQR reporting process during the audit period, resulting in inflated prices for a small portion of its sales of energy to MISO and Tenaska during the audit period.

2. *Incorrect customer name, transaction quantity, and total transaction charge:*

Empire reported numerous transactions with incorrect customer names, transaction quantities, and total transaction charges throughout the audit period, but primarily



between Q3 2012 through Q2 2013. During fieldwork, Empire explained that its deal capture system was not properly coded to always identify the correct counterparty for its sales. These errors resulted in incorrect billings, which were identified after Empire's month-end closing process when Empire staff populates the EQRs. The errors were corrected for financial settlement and Form No. 1 reporting purposes, but not in the EQR submissions.

### 3. *Incorrect Point of Delivery (POD) and POD-Specific Location (POD-SL)*

Empire did not report the correct point of delivery (POD) and point of delivery – specific location (POD-SL) for a significant amount of its transactions in EQRs during the audit period. Empire reported the ultimate sink point of the energy it sold to counterparties in the POD and POD-SL fields instead of the point at which Empire delivered the energy to the counterparties. This incorrect reporting was caused by Empire's misinterpretation of the EQR Data Dictionary, which defines POD as "the specific location at which the product is delivered. If receipt occurs at a trading hub, a standardized hub name must be used." The vast majority of Empire's transactions during the audit period occurred at the border of its service territory, i.e., with the POD of Empire District Electric (EDE), at which point Empire sold or "delivered" the energy to counterparties, and title to the energy transferred from Empire to the purchasing counterparty. However, in its EQRs Empire reported the POD that was listed on the transmission e-tags created by the purchasing entities, which is the ultimate sink point of the energy and not the actual POD and POD-SL of Empire's sale.

### 4. *Incorrect affiliate identification*

Empire improperly reported the majority of its counterparties as affiliated entities in the contracts section of its 2010 to 2013 EQR filings, and one counterparty (Sunflower Electric Power Corporation) as affiliated in its Q4 2014 EQR. Empire explained that each instance where a counterparty was listed as affiliated was an error resulting from inadequate oversight of its EQR processes and procedures, as Empire did not have any affiliates with MBR authority during those periods.

## **Recommendations**

We recommend that Empire:

5. Conduct an internal review of its EQR filings from Q3 2013 to present to identify any additional inaccurate or inconsistent data.
6. Refile all affected EQRs filed from Q3 2013 to present, addressing the findings identified in this audit report and any additional findings identified through internal review.

7. Modify written policies and procedures and institute appropriate controls within 90 days of issuance of this audit report to ensure that all future EQR filings are complete and accurate.

## Appendix A

### V. Empire's Response to the Draft Audit Report



Kelly S. Walters  
Vice President and  
Chief Operating Officer - Electric

July 15, 2016

Bryan K. Craig  
Director and Chief Accountant  
Division of Audits and Accounting  
Office of Enforcement  
Federal Energy Regulatory Commission  
888 First St. NE, Room 5K-13  
Washington, D.C. 20426

In Reference to:  
Office of Enforcement  
Docket No. PA15-7-000

Mr. Craig,

The Empire District Electric Company (EDE) received the non-public draft audit report from the Division of Audits and Accounting (DAA) dated June 30, 2016, in the above-referenced docket. We are hereby including our responses and corrective action plans related to the draft audit report which cited two findings of noncompliance and seven recommendations.

#### DAA Findings

1. *Non-reporting of wholesale sales of energy and capacity to four municipalities in EDE's service territory or wholesale sales from its hydro facility during the audit period.*

EDE Response: EDE accepts this finding.

2. *Errors in contracts and transactions reported by EDE in its EQRs during the audit period.*

EDE Response: EDE accepts this finding.

EDE notes that it has concerns pertaining to DAA's error three, Incorrect Point of Delivery (POD) and POD-Specific Location (POD-SL), on page 21 of the draft audit report. It is EDE's understanding from the EQR data dictionary that "...if delivery occurs at the interconnection of two control areas, the control area that the product is entering should be used." EDE is concerned that using the POD as the location where the "transfer of title" is completed is inconsistent with other applications for POD such as transmission reservations and power scheduling. EDE will continue to investigate this issue as it may impact reporting of future power sales. EDE, as noted herein, will comply with the recommendation and accept the audit finding related to this issue.

## Appendix A

### DAA Recommendations and Corrective Actions

DAA identified the following recommendations and corrective actions to remedy the findings and other matters noted in its draft audit report:

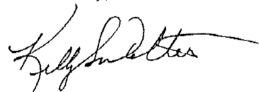
1. Conduct an internal review of its deal capture system and financial records to ensure that it is properly coding, tracking, and reporting in its EQRs all wholesale sales of energy, capacity, and ancillary services.
2. Refile all affected EQRs to include the missing transactions identified in this finding and any additional findings identified through internal review.
3. Modify written policies and procedures to include a reconciliation of deal capture data used for EQR reporting with existing counterparty contracts and settlement data used for financial reporting purposes to ensure that all future EQR filings are complete and accurate.
4. Conduct training of all staff that prepare, review, and file the EQRs to ensure proper interpretation and compliance with Commission EQR reporting requirements.
5. Conduct an internal review of its EQR filings from Q3 2013 to present to identify any additional inaccurate or inconsistent data.
6. Refile all affected EQRs filed from Q3 2013 to present, addressing the findings identified in this audit report and any additional findings identified through internal review.
7. Modify written policies and procedures and institute appropriate controls within 90 days of issuance of this audit report to ensure that all future EQR filings are complete and accurate.

EDE agrees with each of the seven recommendations and corrective actions identified in the draft audit report.

### EDE Compliance and Implementation

As recommended by DAA, EDE will submit to DAA for audit staff review a plan for implementation audit staff's recommendations within 30 days after the final audit report is issued. This implementation plan will address the seven recommendations and corrective actions identified by DAA in the draft audit report. EDE will submit to DAA nonpublic quarterly reports describing EDE's progress in completing each corrective action recommended in the final audit report. EDE will submit these nonpublic quarterly reports no later than 30 days after the end of each calendar quarter, beginning with the first quarter after submission of its implementation plan, and continuing until EDE completes all recommended corrective actions. Additionally, EDE will submit to audit staff in the first quarterly filing after they are completed, copies of any written policies and procedures developed in response to DAA's recommendations in the final audit report. EDE expects to have properly addressed DAA's seven recommendations and corrective actions within six months following the issuance of the final audit report.

Sincerely,



Kelly Walters,  
Vice President and Chief Operating Officer-Electric

Document Content(s)

Delegated Letter.DOCX.....1-28